

**COUNTY OF MILWAUKEE**  
**Inter-Office Communication**

**Date:** May 8, 2003

**To:** Supervisor Lee Holloway, Chairman, Milwaukee County Board of Supervisors  
Scott Walker, Milwaukee County Executive

**From:** Terry D. Kocourek, Fiscal & Budget Administrator, Department of Administrative  
Services – Fiscal Affairs Division  
Jerome J. Heer, Director of Audits

**Subject:** Budgeting for the Cost of Accumulated Sick Leave [File No. 02-503(a)(d)]

**Background**

A September 2002 report by the Wisconsin Legislative Audit Bureau recommended that “Milwaukee County establish a system to more accurately budget for the cost of accumulated sick leave at the time of retirement.” The report noted that the payment of employee sick leave balances comes from departmental operating budgets. The report further highlights the fact that no attempt is made to estimate, and budget for, the cost of the sick leave payments. The situation is made more challenging by fluctuations in the level of payments from year to year. The Legislative Audit Bureau recommendation was included in the 2003 County Executive’s Recommended Budget and subsequently deleted from the budget and referred as a policy item to the Committee on Finance and Audit. As a result of the Committee’s deliberation, a resolution was adopted calling for the Department of Administrative Services and the Department of Audit to develop a system for sick leave budgeting in time for use in the 2004 Budget.

Concerns of the Legislative Audit Bureau were based on the treatment of accumulated sick leave under the current employee benefit structure. In late 2000 and early 2001, the County Board adopted 2001—2004 wage and benefit packages for the County’s non-represented employees and all employees represented by collective bargaining units except for deputy sheriffs. A major component of each of those packages was a change in the manner in which the County treats sick leave hours accrued by retiring employees.

Prior to enactment of the 2001—2004 wage and benefit packages, retiring employees were allowed to take unused sick leave either in the form of a lump sum payment or as ‘retirement leave.’ Sick leave taken in the form of retirement leave was credited as pension service. In addition, employees could continue to accrue additional sick, vacation and personal hours as if they were actually working.

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The amount of accumulated sick leave that could be utilized under either the lump sum or retirement leave option was capped for non-represented workers at 400 hours plus 16 hours for each additional 100 hours (or increment thereof) of accrued sick leave. The cap for represented workers varied by individual collective bargaining unit and generally ranged from 240 to 400 hours plus 16 hours for each additional 100 hours. Members of the deputy sheriffs union had no lump sum payout option. Instead, they were able to receive additional pension service credit for all accrued sick leave.

The 2001—2004 wage and benefit packages eliminated the retirement leave option for covered employees. Instead, all employees hired before January 1, 1994 (with the exception of the deputy sheriffs, who had not reached a contract agreement at that time) were to receive a lump sum payment, with the payment reflecting all accrued sick leave. For retiring employees who were hired on or after January 1, 1994 (post-1993), the new procedures stipulated that the value of accrued sick leave be calculated in the same manner as for pre-1994 hires. However, instead of receiving the value of accrued sick leave as a lump sum payment, retirees hired after 1993 could utilize the value of the accrued hours only as a credit to purchase County health insurance after retirement.

In response to controversy about the cost of this benefit (and others adopted as part of the 2001—2004 wage and benefits negotiation), the sick leave payout for non-represented employees was reduced as of March 15, 2002 to the formula in effect prior to November 2000. The option of converting sick leave to retirement leave was not reinstated. This change in benefits for non-union employees is currently the subject of litigation. Represented employees (with the exception of deputies) continue to have 100% of their sick leave balance paid upon retirement. Employees hired after March 15, 2002 may accumulate sick leave and are provided credits for the purchase of health care premiums based on their final wage rate for up to 400 hours plus 16 hours per 100 hours beyond the 400.

## **Analysis of Cost**

### **2002 Cost**

A February 4, 2002 County Board Staff/Audit report on potential sick leave payouts identified a liability of \$28.2 million for the sick leave balances of all employees eligible to retire as of the end

of 2002. (This represented a \$15.9 million increase in the liability associated with the previous benefit level).

During 2002, actual payouts for accumulated sick leave upon retirement totaled \$7.0 million. The majority of this expense was incurred just prior to the March 15, 2002 termination of the 100% payout for non-represented employees. Actual payments after March 15, 2002 as well as projected costs in the remainder of this report are based on the elimination of the 100% accumulated sick leave payout for non-represented employees. Currently, these individuals represent about 18% of the County's workforce and account for about 24% of the total cost of anticipated sick leave payouts over the next several years.

#### 2003 Projected Cost

As of April 12, payouts of sick leave balances during this year have been \$576,000. While it is difficult to predict, if 2003 follows the same pattern as the last nine months of 2002, accumulated sick leave payouts for 2003 will be approximately \$2.8 million.

#### Projected Cost for 2004 and Beyond

By May 1, 2004, employees hired prior to 1982 will have earned the maximum 25% pension enhancement provided in the 2001—2004 wage and benefits package. As a result, there will undoubtedly be a significant number of 2004 retirements. However, it is difficult to predict with any accuracy the extent to which this will occur. A number of personal circumstances (e.g. the job prospects for those seeking other employment, individual financial obligations, investment returns for those with funds in the stock market) could impact the level of retirements. The relative lack of experience related to the influence of the back-DROP provision in employees' retirement decisions further complicates efforts to predict retirement patterns. Conditions in the County workforce driven by 2004 budget decisions could also affect the number of retirements.

While it is difficult to predict the precise number of retirements in any given year, it is clear that the County faces a large glut of sick leave payouts in the foreseeable future. Based on age and years of service, we estimate that 2,462 current employees that qualify for sick leave payouts will be eligible to retire within the next five years (2004—2008). Further, we estimate that 1,285 of these employees will be eligible to retire as of year-end 2003, with an estimated sick leave payout of approximately \$19.8 million. The likelihood of all 1,285 individuals retiring in a given year is remote,

but it is reasonably certain that the County will pay something close to this amount of money to these individuals within the next several years.

Beyond 2004, we estimate between 237 and 250 additional current employees will become eligible for retirement annually through year-end 2008, with an additional likely sick leave payout of between \$2.6 million and \$4.1 million each year, on top of the previously-mentioned \$19.8 million.

In summary, while the particular timing of these pending retirements is uncertain, the impact of associated sick leave payouts in the short term is more predictable. With more than half of the individuals eligible to retire within the next five years able to do so by the end of this year, a substantial portion of the potential sick leave liability is locked in for the near-term, even in the worst-case scenario of massive layoffs. **Table 1** shows the number of potential retirees and their estimated sick leave payouts, based on current balances and wage rates. It should be noted that to the extent individuals eligible to retire remain actively employed, these figures have the potential to either increase or decrease based on actual sick leave use.

**Table 1**  
**Estimated Sick Leave Payout Liability**  
**Active Milwaukee County Employees**  
**Eligible to Retire as of Year-End 2003—2008**

<u>Year</u>	<u>Number Eligible</u>	<u>Estimated Payout Liability</u>
2003	1,285	\$19,754,747
2004	206	2,591,583
2005	247	3,350,481
2006	237	3,149,949
2007	237	3,573,978
2008	<u>250</u>	<u>4,058,076</u>
<b>Total</b>	<b>2,462</b>	<b>\$36,478,814</b>

Note: Assumes current sick leave balances and wage rates; annual accumulation of 60 additional sick hours and 3% wage increases after 2003. Pending litigation affecting non-represented employees could add approximately \$10 million to the total liability identified in this table.

Source: Department of Audit from payroll files as of 4-12-03.

## **Budgeting for Cost**

### Impact Countywide

Accumulated sick leave payouts during 2001 were approximately \$1.7 million. For 2002, this amount increased to \$7.0 million as many non-represented employees accelerated retirement plans to avoid reductions in their sick leave payouts. We have already noted that 2003 payouts are on pace to total about \$2.8 million. Based on the estimates provided in **Table 1**, it is clearly possible for those payouts to total anywhere within a range of \$5 million to \$10 million annually for the next several years, with the likelihood that 2004 and 2005 will fall near the higher end of that range. While these expenditures are significant on a Countywide basis, the impact on operating budgets of departments can be more problematic.

### Impact on Departmental Budgets

Departments have historically absorbed the cost of accumulated sick leave payments within operating budgets. This was accomplished in large part by leaving positions vacated by retirements unfilled for a time sufficient to pay for the sick leave obligations with vacated salary funding. This practice did not change in 2001 when the accumulated sick leave liability more than doubled under the new wage and benefits structure. The impact of the benefit change was not onerous in 2001, the first year of the current package. This may be a result of individuals deferring retirements until they achieve all or a portion of the 25% pension enhancement. The impact in 2002 was significant, but manageable because a majority of the sick leave payments were generated in the first three months of the year, when employees retired amidst anxiety about benefit changes. The cost of the payments was absorbed by holding positions vacant. The Legislative Audit Bureau noted that, as of August 2002, the Parks Department had \$1.2 million in 2002 sick leave payouts compared to total payouts of \$1.7 million Countywide in the previous year.

For 2003, 2004 and beyond, the impact of sick leave payments on operating budgets could be more burdensome. The impact would be most severe if the volume of retirements is significant and if the retirements occur too late in the year to be offset with vacated salary funding or other budget reductions.

## **Consideration of Other Jurisdiction's Budget Approaches**

As noted by the Legislative Audit Bureau, the State of Wisconsin also allows employees to accumulate unused sick leave. Similar to Milwaukee County's policy for employees hired after

1993, the unused sick leave is used to pay post-retirement health insurance premiums. However, unlike Milwaukee County, the State has set up a fund that is supported by a percentage of each agency's payroll. The trust is managed by the Wisconsin Employee Trust Funds. The actuarially determined payroll percentage for 2003 is 2.8%. Other State governments use a percentage-of-payroll funding approach for cash payments or for conversion to post-retirement health insurance.

Milwaukee County uses a similar approach for funding other employee benefits. Pension, health insurance and life insurance are included in the 37.29% fringe benefit rate currently applied to wages. Actual payout of accrued sick leave for 2001 and 2002 represented approximately 0.7% and 2.8% of payroll, respectively. The average annual sick leave payout liability over the next several years, obtained from our estimates in **Table 1**, also reflect about 2.8% of the County's approximately \$250 million current base payroll. Unfortunately, Government Accounting Standards Board (GASB) rules do not allow for smoothing these costs over a number of years for all employees. Under current GASB rules, governmental funds and proprietary funds (e.g., funds for internal services such as IMSD and Risk Management as well as enterprise funds, which include Airport, Transit and Behavioral Health) account for accrued sick leave differently. Currently, Milwaukee County records a liability for proprietary fund departments. The General Fund records only a liability for those people who would leave during the first 60 days of the new year. GASB does not allow for any additional accrued liability based on actuarial estimates for General Fund departments.

The State of Wisconsin is allowed to determine an actuarial percentage because the sick leave earned at retirement is turned into a health insurance benefit. If sick leave is simply paid out at retirement, pre-funding would not be allowed under GASB rules. Therefore, Milwaukee County could consider pre-funding for the post-1993 employees whose sick leave is turned into a health insurance benefit. In addition, the County could adopt the State of Minnesota rule for this post retirement health insurance, which would exclude the employer and employee from FICA tax and State and Federal taxes on the employee portion.

The sick leave payout for General Fund employees hired before 1994 cannot be pre-funded, since it is a compensated absence subject to GASB rules. However, a mechanism could be adopted to spread the cost of the payments more evenly across County government and to develop historical data to more accurately budget for these costs.

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Applying this approach by budgeting a percentage of payroll for 2004 would give the appearance of a larger property tax increase in operating budgets, but would achieve the accuracy and stability envisioned in the Legislative Audit Bureau recommendation. To some extent, there could also be salary offsets in anticipation of vacancies that will not be filled immediately, or not filled at all.

### **Other Matters for Consideration**

This report addresses the long-term challenge of budgeting for accumulated sick leave expenses. One other approach would be to confront the immediate challenge of funding the cost of 2004 payments with a one-time source (e.g. land sale, debt restructuring) and develop a track record in future years for better budget forecasting. With more experience, the expense could be budgeted directly as a separate line item or absorbed with position vacancies. This latter option, while problematic for operating departments, helps mitigate the necessity of identifying 'new' sources of funding.

Consideration could also be given to alternatives to the current benefit. These alternatives could include development of a cafeteria benefit plan or group disability in lieu of sick leave accumulation. For represented employees, any change for existing or new employees would have to be achieved via collective bargaining. For non-represented employees, the pending litigation will dictate the manner and extent to which there may be any changes. If Milwaukee County prevails in the lawsuit, an alternative could be pursued for new and/or existing non-represented employees.

Any potential change to the benefit should be based on a thorough analysis of legal, fiscal, labor and human resource impacts.

### **Conclusions and Recommendation**

The impact of accumulated sick leave payments on operating budgets is significant and, to a large extent, unpredictable. The State of Wisconsin and other states use a method of budgeting for these costs based on an actuarially determined percentage of payroll expense. This type of method could be adopted to fund the cost of accrued sick leave conversion to health insurance premiums for employees hired after 1993. For those hired prior to 1994, payments could be budgeted as a percentage of payroll for expenses incurred up to 60 days into the next year. While this approach does not reduce the cost of the benefit, it does provide a rational basis for allocating the cost across the entire payroll of the government. One benefit of this method is the development of actuarial data

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on the exact amount to be budgeted. Another benefit is achieved by spreading the cost and budgeting impact across the entire payroll of Milwaukee County. This can help avoid situations where a disproportionate number of retirements in a department could drive a unit's operating budget into a deficit. *Therefore, we believe that it is appropriate to create a centralized accumulated sick leave funding method based on a percent of payroll.*

We recommend that this report be referred to the Committee on Finance and Audit for policy consideration and that the County Executive consider the conclusions of this report for possible inclusion in his Recommended 2004 Budget.

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TDK/JJH/cah

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